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## **Major Challenges for Housing Development in the Next Millennium**

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### ***An Overview of the Issues***

There will be two important factors determining housing development in Hong Kong in the first two decades of the next millennium. The first is the growing integration of the Special Administrative Region with its neighbors in the Pearl River Delta. The second is the emerging network of global cities of which Hong Kong is a part and also aspires to become a vital node. These two realities will form the economic and demographic landscape that will shape urban planning parameters and housing development in Hong Kong.

These two factors will be powerful factors driving our economy. Moreover they are likely to be not only complex in the static sense of impacting every sector of economy in conflicting ways, but will also be two highly dynamic forces that will add uncertainty to the development environment. They will put enormous demands for greater flexibility on our system of urban planning of which housing development forms a crucial part.

To an economist like myself that flexibility obviously refers to the need for greater respect of market forces. What is needed is a framework of rules and institutions that will allow private initiatives to perform a greater role in meeting those planning and housing demands. In the recent past, we have seen a number of changes in the policy institutions responsible for urban planning and housing development. I refer to the greater deployment of financial incentives in meeting housing demand as opposed to physical planning, the creation of reserves in land supply, the greater flexibility in the conversion of land use, and the renewed thrust to speed up urban renewal. But I think this is only the beginning of that process, much more has to be done.

I would like to explore on this occasion the implications of the two factors that I have mentioned for urban planning with a focus on housing development. Towards the end I shall draw some implications for the work of those authorities responsible for urban planning and housing development.

### ***The Emergence of Global Cities***

The emergence of the global cities is a result of the new international division of labor that has created a new spatial organization of production that is decentralized and dispersed on a global or transnational scale. Global cities are, broadly speaking, those urban centers which are at the nexus of global economic decision-making. These cities are integrated and functioning elements in a global network. Global cities, individually and through their network partners, are increasingly responsible for key economic decisions relating to the allocation of capital (both human and financial); influencing governments worldwide directly

and through investment decisions; and hosting global corporations, international organizations, and cultural institutions.

The network of global cities in turn impacts the spatial organization of production and product and service markets. The location of multinational enterprises in the network of global cities and their ability to direct the location of branch plants and offices around the world, particularly in developing areas, has an important bearing on the future of each city. In short, global cities are emerging as the crossroads for people, capital and information, the grist for today's global mill.

Banks and financial institutions have followed their clients, the multinational enterprises, as they relocate their headquarters across the network of global cities. This has in turn helped create an increasingly integrated global financial market with major implications for the conduct of urban planning and housing development decisions as local property markets become integrated into the global economy.

### ***New International Division of Labor***

The new international division of labor that has emerged means that production is increasingly organized and managed on a global or transnational scale, tying previously independent economies directly into the global market place. This mode of global production is in turn closely related to the emergence of global corporations, which can internalize many specific product markets; allocate capital globally to the most profitable locales; and gather, process and communicate information on a global scale to carry out its functions. These functions virtually force global corporations into cities creating global cities, which reinforce the rise of global corporations.

The new international division of labor represents one important facet of structural economic change facing cities. Related to the new international division of labor is the dominance of the service sector in advanced economies and the relative decline of goods production due in part to higher wages in developed economies and rapid technological change reducing employment in goods producing industries. Highly skilled service activity, comprising mainly managerial and professional work, is much less dependent on the locational criteria of the earlier industrial era. Thus, these activities are essentially "footloose" and locational choice for producer services will be increasingly quality of life driven because employees and management of high value added service firms increasingly prefer living in high quality and secure surroundings. The physical environment is also increasingly important as an attractor of the highly skilled labor pool needed to drive knowledge based service industries. Clean air and water, and recreational and young family oriented activities provided by a high quality natural and built environment do matter and will likely matter more in the future of restructured urban and global economies.

The move to services also suggests that there will be a tendency towards a bimodal distribution of job opportunities in the global city typified by higher paying managerial and professional jobs and lower paying semi- or unskilled jobs in the services. This implies that the resulting housing demand should also be bimodal, where high priced apartments are being built simultaneously with more affordable units. If the income difference between the two groups is significant then political pressure will mount for greater public intervention into the housing market to provide subsidies to the lower income households.

Although the foregoing is important, perhaps the greatest driver of urban economic change is the highly open and cyclical nature of urban economies. Their openness to external shocks

stem from the link to the global network and is the source of their high volatility. To survive cities must be highly adaptable and flexible. The need to be flexible and adaptable, because they cannot diversify themselves very greatly forces cities to be more accommodating than larger economies. Their smaller scale and greater degree of openness to outside competitive conditions and economic forces imposes on urban economies a more stringent discipline in policy matters. The inability of cities to provide large subsidies to inefficient private or public enterprises implies that these enterprises must be more competitive and adaptable. The inexorable need to be responsive to external forces ironically provides cities with their essential economic and evolutionary “fitness”.

### ***Integration with the Pearl River Delta***

Hong Kong has undergone two decades of rapid economic integration with the Pearl River Delta. The vast income gap between the Hong Kong and South China provide powerful incentives and huge gains for the two economies to become integrated. Full integration is unlikely to happen because of provisions in the Basic Law that limits the free flow of population from the Chinese Mainland into Hong Kong. Moreover full integration would also precipitate an intolerable social situation in Hong Kong that would trigger off political forces to halt further integration. The tension between economic and social-political objectives will be a long-term feature of the relationship defining Hong Kong’s interaction with its Chinese hinterland. Nevertheless the balance of forces will inevitably shift in favor of further integration for the simple reason that the economic future of Hong Kong will be otherwise compromised.

As economic integration of the two places progresses, the flow of goods and population between them will grow. The increased level of economic activity will also attract foreigners interest to Hong Kong and the Pearl River Delta to take advantage of the new opportunities that would emerge. As the composition of the population in Hong Kong changes to reflect the larger proportion of temporary residents, cross-border commuters and visitors it will also have an impact on the pattern of housing demand. Economic integration would also create fresh demand for road and rail links, and possible a bridge linking Hong Kong to Zhuhai.

Better economic opportunities and improved transportation systems would not only increase the flow of population, but may also gradually alter the settlement patterns of the people in this more integrated region, especially if other support services improve across the border. A crucial factor determining the settlement pattern is the relative cost of living between the two places. The cost of living may well vary across different demographic groups. The scenario of Hong Kong’s elderly population settling across the border to take advantage of the lower cost of living there is a likely one. On the other hand, young entrepreneurial and highly skilled professionals from across the border would be attracted to Hong Kong and could even be welcomed as either permanent or temporary residents.

One crucial component of the differential cost of living is the cost of housing. Interestingly this is and can be a policy variable that could be operated by Hong Kong to shape its future population composition and structure. A generous policy to provide subsidized housing in Hong Kong would delay settlement across the border and at the same time generate powerful incentives for our cross-border neighbors to settle here, unless it is supplemented with draconian discriminatory measures. An alternative policy that raises housing cost in Hong Kong would create a natural economic barrier that would deter settlement here except for the highly productive population. The pace of urban renewal could also be a factor influencing the pattern of settlement. Large stocks of old run down buildings would also encourage settlement in Hong Kong because they reduce the cost of living in Hong Kong. The strategic

choice we take will have long term consequences for the kind of population we will end up with and the kind of city we will be creating. Many cities in the developing world have faced this problem, but few have such a powerful tool at their disposal to allow them to make a conscious choice.

### ***Globalization of Financial and Property Markets***

The internationalization of financial markets began in the post-war era in Europe but has now spread throughout the world with the emergence of the new international division of labor. Technology has created the possibility of a truly global financial market, leading to greater efficiency via instantaneous global flows of information and more competition. Another factor in financial market globalization is the deregulation and liberalization of financial markets in the 1970s and 1980s. Deregulation led to the integration of domestic financial systems into a single global financial market, where no country can regulate its financial sector in isolation. Globalization will intensify as borrowers seek the cheapest sources of funding, no matter where they are located, and investors take advantage of liberalized financial markets for portfolio diversification, yield enhancement and new investment opportunities.

Yield enhancement and diversification are also thrusting urban property markets onto the global business stage. Local housing markets now operate in a global context, suggesting that urban housing policy must increasingly be aware of the international forces impacting their local setting.

The collapse of real estate markets in North America, Europe and Japan in the 1990s and in the Asia-Pacific region (including the urban housing markets on the Chinese Mainland) in the late 1990s has clearly slowed the pace of international real estate investment in and from these countries. However, the international real estate investment frenzy of the late 1980s and the early 1990s led to the present irreversible state of widespread foreign ownership of real property in virtually all global cities and the emergence of a global real estate market today.

Real estate markets are becoming linked along lines that were so clearly noticeable in financial markets. As information becomes global, cities are being forged into an extraordinarily powerful network of financial and managerial functions, financial and economic information flows essentially instantaneously among these cities. As more multinational corporations, especially international banks and financial firms and their clients, locate regional and branch offices in global cities, information about the cities themselves and their property markets is poured into the information networks linking global cities. This free flow of urban economic and property information combines with the free flow of financial capital to create the basis for a global property market.

The potential for globalization of real estate markets started to be realized with the accumulation of huge capital pools that could flow among the cities of the network in response to economic information about these cities and their property investment opportunities. These large pools of capital arise from several sources. First, large trade surpluses created by the new international division of labor have been important. Second, the burgeoning coffers of pension funds in North America, Europe and Japan is another source. The Chinese and Japanese have been important global investors in real estate, and before them the British, Dutch and German investors.

The cyclical behavior of real estate markets needs to be treated explicitly here so as to appreciate better the consequences arising from the interaction of the behavior of property markets with the volatility of open urban cities. Real estate has some unique and defining traits that differentiate it from other real and financial assets. It is durable so that the supply of real estate assets is comprised of the year's production and also the standing stock, which has accumulated over decades. It is also highly regulated so that producing new buildings takes time. Real estate production is very capital intensive and is typically heavily reliant on the availability of highly leveraged debt financing both for the developers of real estate assets and for the purchasers. Finally, the demand for real estate is not only a function of the volatile availability of capital noted above, but also of the fluctuations of the local and open urban economy.

These features when taken together suggest that real property markets will be highly cyclical in their traditional localized setting. This is worsened considerably by the close and highly sensitive link to interest rate changes due to monetary and exchange rate policies and urban economic cycles. Placing property markets in a global context does nothing to reduce the volatility of these once purely local markets and their cycles. Globalizing property markets is likely to make them considerably more volatile and heighten the already substantial challenge of managing them.

Can we hope to manage such volatility? I seriously doubt it, if by management we mean to stabilize such volatility. To begin with we do not control the interest rate. Moreover our economic cycle is largely driven by external forces over which we have no control. Any attempt to regulate the market supply of land or housing by administrative measures is highly unlikely to be successful for two reasons. First, the lag time for government to recognize changes in market conditions is subject to considerable uncertainty. Second, the lag time required to implement and complete a revised production plan is long and may be subject to uncertain delays. Indeed administrative intervention is more likely to exacerbate volatility rather than to reduce it.

This conclusion is of course well known to macroeconomists who have been debating for decades the advisability of devising a stabilization program for smoothing business cycles. The economic debate has essentially been settled in favor of adopting rules rather than discretion because the attempts to stabilize the economic cycle have not only failed but also have made the economic environment even more uncertain. Discretionary policy introduces an additional element of uncertainty that is not helpful for economic stabilization. Government should refrain from taking discretionary decisions to stabilize property markets, except in the unusual situation when the economy is faced with a financial meltdown.

### ***Conclusion***

There are many implications that we can draw from the foregoing discussions of Hong Kong's globalization and its integration with the Pearl River Delta.

The growing links of the network of global cities of which Hong Kong is already a part subjects Hong Kong to the vicissitudes of global market conditions. One cannot be immune from the effects of such external forces. Government policy is better advised to focus on creating a framework that would (1) ensure integrity and soundness of the financial system and its institutions, (2) adopt a simple and transparent set of planning rules that would reduce the uncertainty and cost of development so that the private sector would be able to respond quickly to changing market conditions, and (3) focus on meeting long term housing development goals.

The problems of an aging population, a relative paucity of births, and the increasing importance of international and interregional migration (both legal and illegal) are all facets of the demographic forces shaping the future of our city and its property and housing markets. Accommodating new immigrants and changing tastes will require alterations to current development and land use regulation, leading to new land use forms and densities which are not easily possible at present.

International and interregional migration is a particularly important issue. International migration further internationalizes and connects Hong Kong to other global cities. As the recipient of international migrants Hong Kong will further extend its global reach and facilitate the flow of international economic information and capital. Interregional migration could facilitate greater integration of Hong Kong with the Pearl River Delta in different ways depending on the pattern of migration. What pattern would fit in with the overall goals of Hong Kong's future is a matter of choice and there are levers at the disposal of the immigration, planning, housing, and transportation authorities here to make it happen.

I think the next millennium presents many challenges in the area of housing development. But it is absolutely essential to address these challenges not as housing problems in isolation, but as part of the challenge to achieve Hong Kong's long term development goals. I also believe that our government has the policy levers to make that happen.